

corporation, a retail clothing store, from unrelated third parties.

(ii) Under paragraph (a)(4) of this section, F is treated as owning nonvoting stock of Y. Although X is a disqualified person, its holdings are not treated as held by disqualified persons except as constructive holdings. Therefore, the “deemed” nonvoting stock in Y is a permitted holding because D, a disqualified person with respect to F, constructively owns only 16% of the voting stock of Y (less than 20% permitted under section 4943(c)(2)).

Example (3). (i) The facts are the same as in *Example (2)*, except that X purchases 100% of this stock of Y corporation. Under paragraph (a)(4) of this section, F is treated as owning nonvoting stock of Y. The “deemed” nonvoting stock in Y is not a permitted holding because D, a disqualified person with respect to F, constructively owns 40% of the voting stock of Y.

Example (4). (i) D, a disqualified person with respect to F, owns 40% of the one class of stock in X corporation, an active business. X is a disqualified person with respect to F. X acquires 40% of the voting stock in Y corporation. Under paragraph (a)(5) of this section, the holdings of X in Y are treated as held by a disqualified person. F cannot hold any Y stock, voting or nonvoting.

[T.D. 7496, 42 FR 46285, Sept. 15, 1977, as amended by T.D. 7944, 49 FR 6484, Feb. 22, 1984]

§ 53.4943-9 Business holdings; certain periods.

(a) *Taxable period*—(1) *In general.* For purposes of section 4943, the term “taxable period” means, with respect to any excess business holdings of a private foundation in a business enterprise, the period beginning with the first day on which there are such excess business holdings and ending on the earliest of:

(i) The date of mailing of a notice of deficiency under section 6212 with respect to the tax imposed on the holdings by the section 4943(a);

(ii) The date on which the excess is eliminated; or

(iii) The date on which the tax imposed by section 4943(a) is assessed.

For example, *M*, a private foundation, first has excess business holdings in *X*, a corporation, on February 5, 1972. A notice of deficiency is mailed under section 6212 to *M* on June 1, 1974. With respect to *M*’s excess business holdings in *X*, the taxable period begins on February 5, 1972, and ends on June 1, 1974.

(2) *Special rule.* Where a notice of deficiency referred to in subparagraph (1)(i) of this paragraph is not mailed because there is a waiver of the restrictions on assessment and collection of a deficiency, or because the deficiency is paid, the date of filing of the waiver or the date of such payment, respectively, shall be treated as the end of the taxable period.

(3) *Suspension of taxable period for 90 days.* In any case in which a private foundation has excess business holdings solely because of the acquisition of an interest in a business enterprise to which paragraph (a)(1) (ii) or (iii) of § 53.4943-2 applies, the taxable period described in paragraph (a) of this section shall be suspended for the 90-day period (as extended) starting with the date on which the foundation knows or has reason to know of the acquisition, provided that at the end of such period the foundation has disposed of such excess holdings.

(b) *Cross reference.* For rules relating to taxable events that are corrected within the correction period, defined in section 4863(e), see section 4861(a) and the regulations thereunder.

(c) *Correction.* For purposes of section 4943, correction shall be considered as made when no interest in the enterprise held by the foundation is classified as an excess business holdings under section 4943(c)(1). In any case where the private foundation has excess business holdings which are constructively held for it under section 4943(c)(1), correction shall be considered made when either a corporation, partnership, estate, or trust in which holdings in such enterprise are constructively held for the foundation or a disqualified person; the foundation itself; or a disqualified person disposes of a sufficient interest in the enterprise so that no interest in the enterprise held by the foundation is classified as excess business holdings under section 4943(c)(1).

[T.D. 7496, 42 FR 46285, Sept. 15, 1977, as amended by T.D. 8084, 51 FR 16302, May 2, 1986]

§ 53.4943-10 Business enterprise; definition.

(a) *In general.* (1) Except as provided in paragraph (b) or (c) of this section

under section 4943(d)(4) the term “business enterprise” includes the active conduct of a trade or business, including any activity which is regularly carried on for the production of income from the sale of goods or the performance of services and which constitutes an unrelated trade or business under section 513. For purposes of the preceding sentence, where an activity carried on for profit constitutes an unrelated trade or business, no part of such trade or business shall be excluded from the classification of a business enterprise merely because it does not result in a profit.

(2) Notwithstanding paragraph (a)(1) of this section, a bond or other evidence of indebtedness does not constitute a holding in a business enterprise unless such bond or evidence of indebtedness is otherwise determined to be an equitable interest in such enterprise. Similarly, a leasehold interest in real property does not constitute an interest in a business enterprise, even though rent payable under such lease is dependent, in whole or in part, upon the income or profits derived by another from such property, unless such leasehold interest constitutes an interest in the income or profits of an unrelated trade or business under section 513.

(b) *Certain program-related activities.* For purposes of section 4943(d)(4) the term “business enterprise” does not include a functionally related business as defined in section 4942(j)(5). See § 53.4942(a)-2(c)(3)(iii). In addition, business holdings do not include program-related investments (such as investments in small businesses in central cities or in corporations to assist in neighborhood renovation) as defined in section 4944(c) and the regulations thereunder.

(c) *Income derived from passive sources—(1) In general.* For purposes of section 4943(d)(4), the term “business enterprise” does not include a trade or business at least 95 percent of the gross income of which is derived from passive sources; except that if in the taxable year in question less than 95 percent of the income of a trade or business is from passive sources, the foundation may, in applying this 95 percent test, substitute for the passive source

gross income in such taxable year the average gross income from passive sources for the 10 taxable years immediately preceding the taxable year in question (or for such shorter period as the entity has been in existence). Thus, stock in a passive holding company is not to be considered a holding in a business enterprise even if the company is controlled by the foundation. Instead, the foundation is treated as owning its proportionate share of any interests in a business enterprise held by such company under section 4943(d)(1).

(2) *Gross income from passive sources.* Gross income from passive sources, for purposes of this paragraph, includes the items excluded by section 512(b)(1) (relating to dividends, interest, and annuities), 512(b)(2) (relating to royalties), 512(b)(3) (relating to rent) and 512(b)(5) (relating to gains or losses from the disposition of certain property). Any income classified as passive under this paragraph does not lose its character merely because section 512(b)(4) or 514 (relating to unrelated debt-financed income) applies to such income. In addition, income from passive sources includes income from the sale of goods (including charges or costs passed on at cost to purchasers of such goods or income received in settlement of a dispute concerning or in lieu of the exercise of the right to sell such goods) if the seller does not manufacture, produce, physically receive or deliver, negotiate sales of, or maintain inventories in such goods. Thus, for example, where a corporation purchases a product under a contract with the manufacturer, resells it under contract at a uniform markup in price, and does not physically handle the product, the income derived from that markup meets the definition of passive income for purposes of this paragraph. On the other hand, income from individually negotiated sales, such as those made by a broker, would not meet such definition even if the broker did not physically handle the goods.

(3) *Affiliated group.* (i) For a common parent corporation in an affiliated group, substitute “consolidated gross income” in subparagraph (1) of this paragraph.

(ii) For purposes of this section, the term *affiliated group* shall have the same meaning as in section 1504(a), without regard to section 1504 (b) through (e).

(iii) Section 53.4943-11(d) provides a transitional rule for certain parent corporations.

(d) *Application of section 4943(c)(6)*—(1) *Program related activities.* If a private foundation holds an interest which is not an interest in a business enterprise because of paragraph (b) of this section (relating to program related activities), and such interest later becomes an interest in a business enterprise solely by reason of failing to meet the requirements of such paragraph (b), such interest will then be subject to section (regardless of when it was originally acquired) and will be treated as having been acquired other than by purchase for purposes of section 4943(c)(6).

(2) *Passive holdings, etc.* (i) Except as provided in subdivision (ii), if a private foundation holds an interest that is not an interest in a business enterprise, and the interest later becomes an interest in a business enterprise (other than by reason of a readjustment as defined in § 53.4943-7(d)(1)), the interest will be treated as having been acquired by purchase by a disqualified person at the time the interest becomes an interest in a business enterprise. The treatment of an interest that becomes an interest in a business enterprise by reason of a readjustment shall be determined under § 53.4943-6 and § 53.4943-7.

(ii) If a private foundation establishes that the events which caused an interest not originally a business enterprise to become a business enterprise were not effectively controlled by the private foundation, then such interest shall be treated as acquired other than by purchase from the time of the change for purposes of section 4943(c)(6).

(iii) See § 53.4943-3(b)(3)(ii) for the definition of effective control.

(e) *Sole proprietorship.* For purposes of section 4943 and the regulations thereunder, the term “sole proprietorship” means any business enterprise (as defined in paragraphs (a), (b), and (c) of this section:

(1) Which is actually and directly owned by a private foundation,

(2) In which the foundation has a 100 percent equity interest, and

(3) Which is not held by a corporation, trust, or other business entity for such foundation.

A foundation may be considered to own a sole proprietorship even though the foundation is itself a corporation or a trust. However, a sole proprietorship which is owned by a foundation shall cease to be treated as a sole proprietorship when the foundation no longer has a 100-percent interest in the equity of the business enterprise. Thus, if and when a foundation sells a 10-percent interest in a sole proprietorship, such business enterprise shall be treated as a partnership under section 4943 and the regulations thereunder.

[T.D. 7496, 42 FR 46285, Sept. 15, 1977, as amended by T.D. 7944, 49 FR 6484, Feb. 22, 1984]

§ 53.4943-11 Effective date.

(a) *In general.* Section 4943 and §§ 53.4943-1 through 53.4943-11 shall take effect for taxable years beginning after December 31, 1969, except as otherwise provided by such sections.

(b) *Special transitional rule.* In the case of any acquisition of excess holdings prior to February 2, 1973, section 4943(a)(1) shall not apply if correction occurs (within the meaning of paragraph (c) of § 53.4943-9) within a period ending 90 days after July 5, 1977 extended (prior to the expiration of the original period) by any period which the Commissioner determines is reasonable and necessary (within the meaning of paragraph (b) of § 53.4943-9) to bring about such correction.

(c) *Special transitional rule for acquisition by will, etc.* (1) The rule in § 53.4943-6(b)(1) whereby holdings not held by a decedent are not treated as acquired under a will shall not apply to acquisitions of after-acquired property of a decedent's estate occurring on or before May 22, 1984.

(2) The rule in § 53.4943-6(b)(1) treating a purchase by an estate as a purchase by a disqualified person where the executor is a disqualified person shall not apply to purchases occurring on or before May 22, 1984.